GLOBAL ECONOMIC OUTLOOK

Coronavirus outbreak represents binary risk for the global economy

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4 March 2020
Global activity recently showing signs of bottoming out

**World: GDP & PMI**

Index

- Global composite PMI (Adv two months, LHS) % y/y
- Global GDP (RHS)

Source: Oxford Economics/Haver Analytics/Markit
With encouraging leading indicators, until...
The coronavirus hit...

Faster spreading virus, but lower mortality rate

Source: Oxford Economics/WHO/CDC

*As of March 3rd, 2020
The coronavirus hit...

Impact of Coronavirus

- **Travel & Tourism**
  - Official bans and restrictions
  - Reduced appetite for business travel
  - Reduce demand for leisure travel

- **Confidence**
  - Consumers pull demand forward
  - Businesses reduce activity
  - Events cancelled
  - Lockdown risk

- **Supply chains**
  - Inventories run down
  - Factory closures in the US
  - Lockdown risk

Financial conditions = Accelerator

Questions: Use the question panel on the right
This time is different because of China’s global role

China's importance to the world economy

% of total

- GDP
- Total imports
- Non-food and non-energy intermediate exports

Source: Oxford Economics/Haver Analytics

Questions: Use the question panel on the right
And because of the lockdown paradox

Coronavirus: Wuhan U-turn on easing lockdown, as China reports 150 new deaths

Coronavirus: Italy towns in lockdown after COVID-19 deaths

In Coronavirus Crisis, Korean City Tries Openness, a Contrast to China

Coronavirus news: Tenerife hotel in lockdown as tourists tested – live updates

Japan shut down an entire island's schools, restaurants, and stadiums after an uptick in coronavirus cases. Here's what it looks like.
Initial data point to large effects on travel and tourism

Hong Kong: Visitor arrivals

Thailand: International arrivals via air

Questions: Use the question panel on the right
Global and US travel disruptions will be large

- Global travel demand is faced with a difficult year ahead, as the outbreak of the coronavirus is set to devastate travel and tourism internationally.
- International arrivals are forecast to decline 1.5-2.0% in 2020, well below global GDP (2.0%) for the first time since the global financial crisis.
- Travel to the US forecast to decline 0.7% in 2020
- Based on historical precedent, a 25% drop in visits to the US from China is expected in 2020 – upward of 1 million visitors each spending $6,500/trip.
A global confidence shock

Not only did Korea’s Business Sentiment Index record a plunge in February, the survey was conducted before outbreak spike.

No impact in February, but coronavirus mentioned by 20% of those surveyed in last 2 days of the month.
PMI readings illustrate forthcoming supply chain disruptions

US ISM PMI® at 50.1%

WHAT RESPONDENTS ARE SAYING

“There are always supply chain challenges with Lunar New Year shutdowns, and this year is no different. Coronavirus is wreaking havoc on the electronics industry. Companies are delayed in starting up production, which is resulting in longer lead times, constraints and increased pricing. It’s a mad dash to dual source stateside in case China isn’t back on line soon.” (Computer & Electronic Products)

“January started out strong, but the effects of the Virus in China [and] the continued grounding of the 737 Max have suppressed new orders. We are still expected to be flat to slightly up [year-over-year] for 2020 sales, based on those issues.” (Chemical Products)

“Layoffs are here...” (Transportation Equipment)

“Coronavirus and its impact on the supply chain... We will see some softness in demand, but also [experience] havoc on items sourced from China that may cause significant delays to production.” (Food, Beverage & Tobacco Products)

“Energy markets seem to be responding to a potential drop in demand that may be related to responses to the coronavirus.” (Petroleum & Coal Products)

“Coronavirus continues to be front and center as a major supply chain risk to our company. Access to information in China — from our supply base and customers — is slow to come by.” (Fabricated Metal Products)

“Sales continue to be strong, with the supply base able to support as required. The major concern is the China virus and what that crisis could affect in getting parts. The company is putting plans in place to source out locations, especially in the U.S., for parts.” (Machinery)

Questions: Use the question panel on the right
And supply chain disruptions will be significant

Global industrial supply chain vulnerability

Gross exports of intermediate products from China as a share of global (exc China) sector gross output

- Electronics
- Electrical equipment
- Textiles
- Non-metallic minerals
- Basic metals
- Rubber and plastics
- Fabricated metal products
- Industrial machinery
- Wood
- Manufacturing
- Chemicals and pharma
- Other transport equipment
- Paper and printing
- Motor vehicles and parts
- Food, beverages and tobacco
- Fuel and petroleum products

Source: Oxford Economics/OECD Trade in value-added database
No V-shape recovery -- Slow resumption of activity
First quarterly fall in world GDP since GFC possible

World: GDP

Source: Oxford Economics/Haver Analytics

Questions: Use the question panel on the right
Exponential rise in global cases lead to renewed fears

Spread of Covid-19 across the globe

Cases

- Mainland China (left axis)
- Other locations (right axis)

Source: Oxford Economics/PRC NHC

*As of March 3rd, 2020
Asia worst affected but economic damage is spreading

Global: Coronavirus shock to 2020 GDP growth

- United States: -0.4
- Eurozone: -0.4
- Japan: -0.8
- China: -1.2

Source: Oxford Economics

Questions: Use the question panel on the right
Europe is entering the eye of the storm

• We’re cutting our 2020 eurozone GDP growth forecast to a seven-year low of only 0.6% from 1.0%.
• Given the extent of the slowdown, elevated risks of a recession in H1 2020, and the region’s pre-existing economic fragility, this calls for a timely response from fiscal and monetary policymakers.

Questions: Use the question panel on the right
Various measures considered to alleviate pain

**Italy**: €3.6bn package (0.2% of GDP), offering tax credits to firms facing a revenue shortfall of 25% or more

**Germany**: Temporary government-backed credit lines, and “Kurzarbeitergeld” which allows unemployment insurance to cover part of firms’ wage bill to avert layoffs

**France**: quarantined people may ask the health insurance system to make temporary compensation payments, guarantee loans if they face temporary liquidity issues
Tightening financial conditions amplify the shock

US: Oxford Economics' Financial Conditions Index

0 = Average stress

Dec 21: (Williams)  
Fed is "listening" to markets

Dec 19: (Powell)  
Balance sheet on "autopilot"

Jan 4: (Powell)  
Fed is "flexible"

Jan 30: (FOMC)  
Fed "patient"

Feb 28:  
Fed will "act as appropriate"

Mar 20: (FOMC)  
No rate hikes in 2019

Jun 19: (FOMC)  
Fed will "act as appropriate"

Jul 31: (FOMC)  
25bp rate cut

Oct 30: (FOMC)  
Fed 25bp rate cut

Nov 28: (Powell)  
"Just below" neutral

Oct 3: (Powell)  
"Long way" from neutral

Source: Oxford Economics

Questions: Use the question panel on the right
The outlook is looking increasingly binary

- Official travel restrictions and anecdotal evidence of reduced appetite for business travel and curtailed demand for leisure trips point to a direct hit to the sector.
- The “virus fear” has generated a private confidence shock with anecdotal evidence of a pullback in discretionary spending, precautionary demand for staples, businesses investigating contingency plans and large events being cancelled.
- **Supply chain disruptions** from China to the US

Damage on economic output is becoming increasingly visible.

US GDP growth in 2020

<table>
<thead>
<tr>
<th>No virus</th>
<th>March baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.7</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Source: Oxford Economics

Questions: Use the question panel on the right.
We continue to stress the main economic risk from the virus is not contagion, or mortality, but rather it stems from the actions that national and local authorities have taken to curb the outbreak – the lockdown paradox.

While our baseline doesn’t feature a lockdown scenario, we note that if authorities decide to close schools, severely restrict travel and limit all nonessential movement, the US economy will fall into a recession – with zero GDP growth in 2020 – putting an end to the longest economic expansion ever.
What a severe global pandemic would look like

If the coronavirus outbreak becomes a global pandemic, the consequences would be much more severe.

→ The virus would put an end to the longest economic expansion on record with GDP tumbling 1.7 ppts relative to a no-virus scenario (output loss would surpass $300bn)

→ Overall, global growth falls to an annual rate of just 0.3% in Q2 2020. In 2020 as a whole, growth is just 1.1%, 1.2 ppts below baseline, costing over $1 trillion in lost output.
Can the Fed save the day?
More rate cuts coming - at least 50bps more

**US: Federal funds rate expectations**

- Market Implied (Mar-3)
- Oxford Economics (Mar 2020)

- Three rate cuts in 2019
- 117bps in cuts in 2020

Source: CME/Federal Reserve/Oxford Economics

Questions: Use the question panel on the right
Meeting-by-meeting rate expectations

US: Market expectations for further rate cuts

Source: Oxford Economics/Bloomberg
Yields collapsing – 10yr yield fell below 1% for first time

US: Yields collapse across the yield curve

Source: Oxford Economics/Haver Analytics
Coronavirus shock is disinflationary

US: Market inflation expectations drop sharply

Source: Oxford Economics/Haver Analytics
Fed to continue to expand the balance sheet and conduct large repo operations

**US: Fed balance sheet and bank reserves**

- Fed's System Open Market Account
- Total Fed balance sheet
- Reserve balances

Source: Oxford Economics/Haver Analytics
Conclusion

Questions: Use the question panel on the right
Main thoughts

- Coronavirus shock used to represent a supply shock for China and rest of world, but it’s rapidly transformed into demand shock too

- Demand-side disruptions are visible in travel activity, confidence shock, fear factor affecting consumers and businesses

- Supply chain disruptions initially represented indirect shock to RoW, but increasingly we’re observing direct shock across world

- Lockdown paradox is most important risk

- Financial condition are acting as an amplifier

- Fed easing won’t stop the virus, or help supply chains, but it can support confidence, ease financial conditions and lower cost of capital

- Coordinate G-7 action is needed but emphasis should be on health, social and credit/liquidity measures
We are looking to support you during these uncertain times with **3-month access** to:

- **All of our Research Briefings**
  
  Receive all the latest research updates from Oxford Economics to monitor the global and regional impact of the coronavirus, the implications for financial markets as well as all of our current thematic research on global economic developments.

- **Our Global Scenario Service**
  
  This service allows you to quantify the effects of the coronavirus spread on our baseline forecasts for the 80 most important countries and compare this with our latest coronavirus pandemic scenario as well as to other current global risk scenarios, such as US or world recession.

If you would like to receive further information, please contact: sales@oxfordeconomics.com
THANK YOU!

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